



SPECIAL REPORT: REVIEW OF HIGHLY PROFITABLE OTS-REGULATED THRIFTS

Office of Thrift Supervision / August 20, 1997

Overview

Over the past three years, excluding the third quarter of 1996 when the SAIF special assessment expense was incurred, approximately one-third of the industry has achieved an annualized quarterly return on average assets ("ROA") in excess of 100 basis points. (ROA of 100 basis points is the traditional threshold of high profitability for thrifts and banks.) Within this group a core of 102 thrifts has consistently generated quarterly ROAs above 100 basis points. These "highly profitable thrifts" ("HPTs") posted ROAs exceeding 100 basis points in 12 of the past 13 quarters, excluding the third quarter of 1996.

This is the first of two papers that will analyze the key financial data that appear to distinguish the HPTs from other thrifts. This first paper reviews the general characteristics of the HPTs and contrasts the HPTs to the industry averages. In general, the HPTs are reviewed as a group in this paper.

The next paper will focus on the different business strategies employed by the HPTs and contrast the HPTs to other thrifts following the same and/or alternative strategies. For example, HPTs that hold adjustable rate mortgages as their primary asset will be compared to thrifts following that same general strategy and to other strategies.

The three year period covered in this paper has been marked by strong economic conditions throughout most of the nation and interest rates generally favorable to the thrift industry. The next paper will review how HPTs, following certain strategies, performed in unfavorable business/interest rate cycles.

The key characteristics of HPTs are as follows:

Very Profitable. As their title suggests, the HPTs attained a level of profitability well above the industry average. Some thrifts among the HPT group had an average ROA over 200 basis points for the 3 year period.

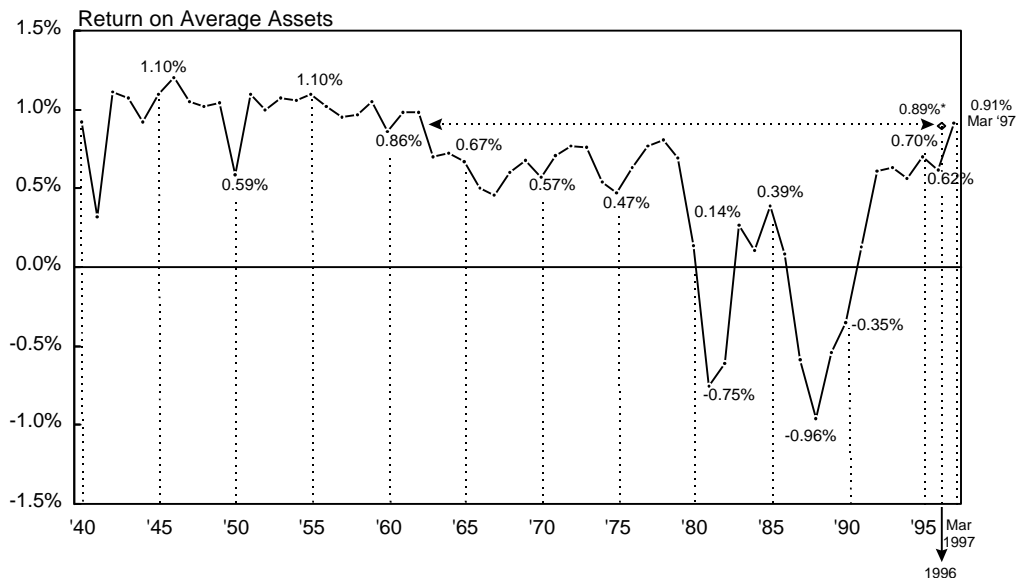
Primarily Mortgage Specialists. Although holding a wide range of loan types, HPTs as a group held a higher percentage of single-family mortgages than the industry as a whole.

Maintaining Sound Fundamentals. Asset quality, efficiency, capital, and management were better for the HPTs than for the industry as a whole.

Above Average Interest Rate Risk. With higher than average profitability comes higher than average risks. In general, the HPTs have above average interest rate risk. The HPTs have managed this risk by maintaining higher capital ratios than the industry as a whole. As discussed later in more detail, the results from the OTS Interest Rate Risk Model show the HPTs' sensitivity measure is higher than the industry average, indicating higher than average interest rate risk. However, even after a hypothetical 200 basis point interest rate "shock", the HPTs would still have capital substantially in excess of regulatory "well-capitalized" levels.

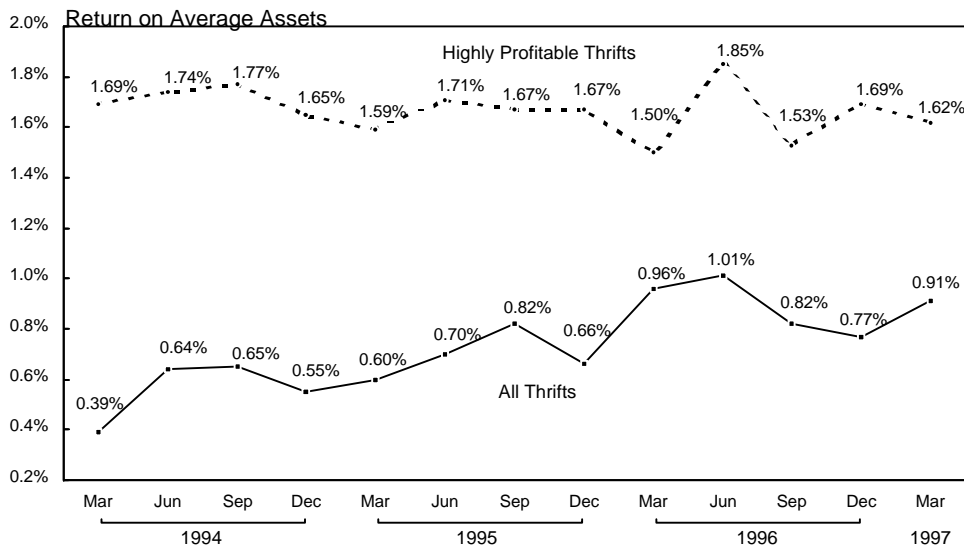
HPTs Significantly and Consistently Exceed Industry Aggregate Profitability

Thrift industry earnings have been strong since 1992. More recently, industry earnings have been particularly strong. Excluding the net impact of the SAIF special assessment on 1996 earnings, industry ROAs for 1996 and for the first quarter of 1997 were almost 50 percent above 1992-1994 levels. ROAs for the industry from 1940 through 1996, and for the first quarter of 1997, are presented in the chart below. As the chart indicates, the OTS-regulated thrift industry last earned an ROA of 90 basis or more in 1962 – almost 25 years ago.



* Adjusted data exclude the net SAIF special assessment of \$2.1 billion incurred in the third quarter of 1996.

ROAs for the HPTs significantly and consistently exceeded even this strong recent industry average profitability. HPTs maintained remarkably high ROAs over the 1994 to current period with a low of just 150 basis points and a high of 185 basis points. The average ROA for this group over the 13 quarters was 169 basis points. The following chart presents the quarterly ROAs for the HPTs and the industry aggregate over this period.



Highly profitable thrifts are defined as those thrifts earning in excess of 100 basis points in each of the past 13 quarters. Third quarter 1996 ROA excludes the net SAIF special assessment.

General Characteristics of the HPTs

Some general characteristics of the HPTs are listed below.

Asset Size The 102 HPTs ranged in asset size from \$22 million to \$6 billion. The average asset size of the HPTs was \$600 million as of March 31, 1997, and was almost identical to the average general thrift size of \$590 million. The median asset size of the HPTs was \$185 million compared to the median asset size of \$108 million for the entire thrift industry.

- The HPTs had combined assets of \$61 billion, or 8 percent of the industry assets. There were relatively more "mid size" and "large" HPTs, and fewer "small" HPTs. The number of HPTs by asset size groupings are presented on the following page. The total number of HPTs represented 7.8 percent of all thrifts at March 31, 1997.

<u>Asset Size</u>	<u># of HPTs</u>	<u>% of All Thrifts in Asset Size</u>
< \$100mm	30	4.9%
\$100mm - \$1b	61	10.5%
> \$1b	11	9.9%
Total	102	7.8%

Asset Growth The HPTs experienced average annualized asset growth of 6.8 percent from the end of 1993 through the first quarter 1997. The average annual asset growth for all thrifts that existed from 1993 through March 1997 (6.6 percent) was almost equal to the HPT growth rate.

- Over that time frame very little (9 percent) of the asset growth of HPTs was attributable to mergers with other thrifts.
- In contrast, roughly half (47 percent) the industry's asset growth for the same period was due to mergers with other thrifts.

Mutual/Stock Mutual HPTs numbered 37 and there were 65 stock HPTs. The percentage of stock HPTs (64 percent) was slightly higher than the overall industry percentage (60 percent).

Location The location of HPTs generally mirrors the relative location of all thrifts by OTS region. The percentage of HPTs and the percentage of all thrifts located by OTS region are compared below:

<u>Region</u>	<u>% of HPTs</u>	<u>% of All Thrifts</u>
Northeast	19.6%	20.1%
Southeast	23.5%	20.2%
Central	30.4%	30.1%
Midwest	18.6%	21.0%
West	7.8%	8.6%
California	1.0%	5.0%

- The Southeast and Central regions both had more HPTs than their relative share of total thrifts. This may reflect the greater housing appreciation rates realized in most of these areas relative to other areas such as California and New England during this period.
- The Midwest region was the "least" represented by HPTs relative to the percentage of all thrifts located in that region.

- The West region was also “under-represented” by HPTs; this may reflect this region’s lagging economy and lower house price appreciation during this period. Only one of the 65 thrifts based in California was in the HPT group further reflecting that state’s lagging economy.

Holding Company Ownership Forty-seven HPTs (46 percent) were owned by holding companies. This compares to holding company ownership of approximately 49 percent of all thrifts. Of these holding companies, 4 were mutual holding companies.

- Of the holding companies owning HPTs, 10, or 21 percent, were involved in non-banking activities. This is about double the percentage (11 percent) of all thrift holding companies involved in non-banking activities.

Subsidiary Investments Sixty-three HPTs (62 percent) owned a total of 186 subsidiaries as of December 31, 1996. This mirrors the 59 percent of the industry owning subsidiaries. Moreover the activities conducted by the HPTs’ subsidiaries are in the same rank order as for the industry. Subsidiary activities most frequently conducted by the HPTs were:

- Real estate development and sales (26 HPTs);
- Insurance activities (23 HPTs); and
- Mortgage lending (20 HPTs).

Business Strategies Substantially all of the HPTs offered and held a wide range of typical community-based loans, e.g. single-family mortgages, consumer loans, commercial and small business loans. However, two of the HPTs held a significant portion of their assets in credit card loans.¹

In general, credit card lending produces large amounts of fee income from charges to cardmembers (e.g. annual fees, late fees, over-limit fees); merchant, or interchange, fees; and if applicable, servicing fees on sold credit card loan portfolios. Due to the typically higher rates of interest on credit card loans, credit card lenders also tend to generate greater amounts of interest income than non-credit card lenders. These advantages held by credit card lenders in generating income are partially offset by higher provisions for losses.

¹ As of March 31, 1997, four OTS-regulated thrifts were “credit card specialists”, holding 25 percent or more of their assets in credit card loans. Credit card specialists are thus disproportionately represented among HPTs.

- The thrift industry, as a whole, holds just one percent of its assets in credit card loans. In contrast, the two credit card specialist HPTs held 40 percent of their assets in credit card loans as of the end of the first quarter 1997.
- For more congruous comparisons between the HPTs and the industry averages, data are presented for the HPTs both including and excluding the two HPT credit card specialists.

Many community-based lending HPTs also seemed to specialize in a particular loan product. As a group, the HPTs held an above average amount of fixed-rate single-family mortgages to their total assets. However, one-third of the HPTs held more single-family adjustable rate mortgages ("ARMs") than fixed-rate mortgages. Among all thrifts, 49 percent held more ARMs than fixed-rate mortgages.

HPTs Have More Single-Family Mortgages and Higher Capital on Average

The table below presents a comparison of major assets and liabilities, expressed as a percent of total assets, for the HPTs and the industry. Data are also presented for the HPTs excluding the two credit card specialist HPTs. Ratios are shown as of the first quarters of 1994 and 1997 -- the beginning and ending periods for the 13-quarter time frame used to define HPTs.

SUMMARY BALANCE SHEET (% of Total Assets)	Highly Profitable Thrifts (HPTs)		HPTs Excluding HPT Credit Card Specialists		Industry Aggregate	
	Mar-94 %	Mar-97 %	Mar-94 %	Mar-97 %	Mar-94 %	Mar-97 %
Assets						
Cash, Non-Interest Demand Deposits	1.9	2.0	1.5	1.4	1.5	1.2
Investment Securities	13.9	10.7	16.5	11.8	15.1	11.1
Mortgage Pool Securities	12.0	9.3	13.0	11.2	15.4	14.2
Single Family Residential Mortgages	40.5	44.5	46.2	51.5	45.2	50.1
Multi-Family Residential Mortgages	3.9	3.5	4.4	4.2	7.4	6.3
Non-Residential Mortgages	4.7	4.6	5.9	5.5	4.7	4.2
Construction and Land Loans	4.1	3.6	5.4	4.4	1.9	1.8
Commercial Loans	1.0	1.6	1.0	1.4	0.5	1.3
Consumer Loans	15.7	16.3	4.4	4.8	4.5	5.4
Reposessed Assets	0.4	0.2	0.4	0.2	0.7	0.3
Real Estate Held for Investment	0.0	0.1	0.0	0.1	0.1	0.1
Liabilities						
Total Deposits	71.3	64.8	74.9	70.2	74.7	68.0
Memo: Less than \$100,000	64.1	56.6	67.7	61.8	66.5	58.4
Memo: Greater than \$100,000	7.2	8.2	7.2	8.3	8.2	9.5
Total Borrowings	15.0	22.1	11.5	16.9	15.6	21.9
Equity Capital	10.0	10.5	10.3	10.2	7.6	7.9

Single-family mortgages were the major asset for both the HPTs and the industry aggregate. Excluding the credit card specialist HPTs, single-family mortgages represented 51.5 percent of the HPTs' total assets, slightly more (about 3 percent) than the industry average of 50.1 percent. For both the HPTs and the industry aggregate, single-family loans increased approximately 11 percent between the first quarters of 1994 and 1997. As discussed later in this paper, most of the HPTs' single-family mortgages are fixed-rate. In contrast, the majority of the industry aggregate's single-family mortgages have adjustable rate features.

The HPTs' also held a proportionately greater amount of construction loans than the industry aggregate. As of the first quarter of 1997, the HPTs' construction loans-to-assets ratio was 4.4 percent – approximately 2.4 times the industry aggregate ratio. The HPTs also had a similar larger investment in construction loans three years ago – 5.4 percent versus 1.9 percent for the industry as a whole.²

Both the HPTs and the industry as a whole have increased the amounts of consumer loans and commercial/small business loans held in portfolio during the three-year period. Excluding the HPT credit card specialists, the HPTs' consumer loans represented 4.8 percent of the HPTs' assets as of the first quarter of 1997 – about 11 percent lower than the industry average of 5.4 percent. In addition, the relative amount of consumer loans held by the industry aggregate rose at a faster pace (20 percent) than for the HPTs' (9 percent).

Commercial/small business loans as a percent of total assets also increased at rapid rates during the period for both the HPTs (40 percent increase) and the industry as a whole (117 percent). Still, commercial/small business loans represent a small proportion of assets for the HPTs (1.4 percent) as well as the industry aggregate (1.3 percent).

Increased direct lending by the HPTs and by the industry as a whole was offset by declines in holdings of securities, including mortgage securities. Both the HPTs and the industry aggregate experienced substantial declines in securities holdings as a percent of total assets between March 1994 and March 1997, falling 22 percent and 17 percent, respectively.

Deposits funded a slightly higher than average percentage of the HPTs' assets for both periods; the difference was primarily in deposits less than

² The decline in construction loans between 1994 and 1997 for both groups was due primarily to a reporting change beginning in 1997. Starting in 1997, asset categories were reported net of loans in process. This change significantly reduced the reported amount of construction loans.

\$100,000. HPTs also held higher than average amounts of low-costing demand deposits.

The HPTs' capital-to-assets ratio was consistently stronger than the industry aggregate's ratio during the three-year period. On average, the HPTs' capital ratio was roughly 30 percent greater than the industry aggregates'. This edge in capital was partly responsible for this groups' higher than average earnings. In addition, this stronger capital level has allowed the HPTs to absorb higher than average amounts of interest rate risk.

Stronger Net Interest Margin and Higher Fee Income Generally Distinguish HPTs Earnings from the Industry Aggregate

The HPTs' average ROA was more than double the industry average ROA for the past 13 quarters. The table below presents the primary components of the average ROA of the HPTs compared to the industry averages for the 13-quarter period. The average ROA for the HPTs is presented both with and without the HPT credit card specialists. As the table indicates, The HPTs' stronger than average ROA was primarily attributable to higher net interest margin and fee income, and lower provisions for losses.

SUMMARY INCOME STATEMENT (% of Average Assets)	Highly Profitable Thrifts (HPTs) %	HPTs Excluding HPT Credit Card Specialists %	Industry Aggregate %
Interest Income	7.76	7.63	6.98
Interest Expense	3.97	3.83	4.17
Net Interest Margin	3.79	3.80	2.81
Provision for Losses	0.37	0.14	0.30
Fee Income	0.73	0.59	0.41
G&A Expenses	2.43	2.16	2.07
Taxes	0.86	0.88	0.38
Other Non-Interest Income	0.88	0.39	0.37
All Other Components	-0.06	-0.04	-0.12
Net Income	1.68	1.56	0.73

Above Average Holdings of Higher Yielding Assets Bolster the HPTs Net Interest Income

The HPTs' average net interest margin exceeded the industry average by almost 100 basis points – about a 35 percent differential. The HPTs' sizable advantage in net interest margin was due to both higher interest income and lower interest expense relative to the industry.

The ratio of interest income to average assets for the HPTs, excluding the credit card specialist HPTs, averaged 7.63 percent over the 13-quarter period -- 65 basis points higher than the industry aggregate ratio. This advantage in the ratio of interest income to average assets explained approximately two-thirds of the HPTs' above average net interest.

Interest income is a function of both the interest rates, or yields, on earning assets and the volume held in earning assets. Analyzing these two components of interest income helps identify the underlying causes of differences in interest income. During the period, it appears that the majority of the HPTs' higher interest income was a result of their holding more higher yielding assets than the industry aggregate.

To estimate the yield on earning assets, interest income was divided by interest earning assets producing a weighted average yield on loans and investments ("WAY"). The HPTs' WAY averaged 8.89 percent; excluding the credit card specialist HPTs, the HPTs' WAY was 8.28 percent. The industry aggregate WAY was 7.73 percent, or 116 basis points lower than that of all HPTs, and 55 basis points lower than the HPTs, excluding the two credit card specialists.

For a relative measure of the volume of interest generating assets, the ratio of interest earning assets-to-total assets is used. The interest earning assets-to-total assets ratio and, hence, the volume of earning assets, was slightly larger for the aggregate industry (92.8 percent) than for the HPTs (91.3 percent). Thus, higher yields were the critical source of the HPTs' edge in interest income.

HPTs' higher yields were primarily generated from their higher than average holding of fixed-rate single-family mortgages and construction loans. Moreover, the WAY of the ARMs held by the HPTs is higher than the industry average due largely to a difference in the primary ARM indexes used by the HPTs versus the industry as a whole.

As of March 31, 1997, fixed-rate single-family mortgages and mortgage-backed securities ("MBS") comprised 39.1 percent of the HPTs' (excluding the credit card specialists) assets compared to 21.5 percent for the industry aggregate. HPTs held higher relative amounts of both 30-year fixed-rate single-family loans and MBS (21.2 percent of assets) and 15-year fixed-rate single-family loans and MBS (14.3 percent) than did the industry aggregate (10.4 percent and 7.9 percent, respectively). Both groups held approximately 3 percent of total assets in balloon fixed-rate single-family loans and MBS.

HPTs hold a lower proportion of their total assets (20.5 percent) in ARMs than the industry aggregate (40.5 percent). Further, the HPTs hold a much lower percentage of their assets (2.5 percent) in lagging index ARMs compared to the industry (20.5 percent). The proportionate holdings of current market index ARMs were similar for the HPTs and the industry – 18.1 percent and 20.0 percent, respectively.

Concentration in fixed-rate single-family mortgages helped the HPTs generate a higher than average ratio of interest income to average assets. Fixed-rate single-family mortgages usually have higher rates on interest than ARMs. For the industry aggregate, the WAY of fixed-rate single-family mortgages was 7.75 percent compared to 7.36 percent for ARMs based on March 31, 1997 rates. As of the same date, the WAY of fixed-rate single-family mortgages for the HPTs was 7.87 percent. Holding relatively more fixed-rate mortgages than the industry average helped boost the HPTs interest income.

In addition, the ARMs held by the HPTs had a WAY of 7.72 percent, 36 basis points higher than the industry average ARM WAY. This difference was likely due to the greater than average percentage of assets held in current market index ARMs held by the HPTs. Having higher yielding ARMs also helped advance the HPTs' relative interest income over the industry average.

Construction loans are typically higher yielding than single-family mortgages. As of March 31, 1997, the HPTs held 4.4 percent of total assets in construction loans – about 2.4 times the industry average of 1.8 percent. All remaining loan and investment categories were equivalent for the HPTs and the industry.

Higher HPT Interest Rate Sensitivity Offset by Stronger Capital Levels

The larger proportionate amount of assets held in fixed-rate loans subjects the HPTs to greater interest rate risk than the industry as a whole. Interest rate risk is quantified by two primary measures from the OTS Interest Rate Risk Model ("IRR Model"): 1) the net portfolio value ("NPV") sensitivity measure; and 2) the NPV exposure measure. The NPV is, essentially, the difference between thrifts' assets and liabilities, both discounted using current interest rates. This NPV is the present value of thrifts' equity. Dividing the NPV by the discounted present value of assets generates the thrifts' equity capital ratio in NPV terms – the NPV ratio.

The sensitivity measure is the estimated change in the NPV ratio resulting from a hypothetical, immediate 200 basis point increase, or decrease, in interest rates – whichever produces the larger decline in NPV. The sensitivity measure

for the HPTs was negative 296 basis points – approximately 51 percent more severe than the industry aggregate sensitivity measure of 196 basis points. The HPTs' higher sensitivity measure generally reflects their greater proportion of fixed-rate loans.

The exposure measure is the NPV ratio after the hypothetical 200 basis point change in interest rates. While the sensitivity measure gauges the degree of the decline in NPV, the exposure measure presents the level of equity capital ratio, in NPV terms, after the projected change in interest rates. Despite the higher than average sensitivity measure, the HPTs exposure measure was 28 percent higher than the industry aggregate. This reflects the HPTs' stronger than average capital levels. The exposure measures for the HPTs and for the industry aggregate were 10.11 percent and 7.87 percent, respectively. Both of these ratios are substantially in excess of the levels needed for the regulatory "well-capitalized" status.

HPTs High Capital Levels and Larger Proportion of Demand Deposits Result in Lower than Average Interest Expense

Excluding the credit card specialists, the HPTs' interest expense-to-average assets ratio averaged 3.83 percent for the last 13 quarters – 34 basis points lower than the industry average of 4.17 percent. The interest expense to average assets ratio, like the interest income ratio, is a result of both volume and rate components.

The rate component of the interest expense-to-average assets ratio, or overall weighted average cost of funds ("WAC"), can be measured by dividing interest expense by the average interest bearing liabilities. Excluding the 2 credit card specialists, the HPTs' overall WAC averaged 4.77 percent over the past 13 quarters, slightly lower than the WAC of the industry aggregate of 4.88 percent. The 11 basis point advantage in overall WAC for HPTs relative to the industry was primarily due to the larger percentage of HPT assets funded by low costing demand deposits. (Demand deposits include: transaction and non-interest demand accounts, money markets deposit accounts, passbook accounts, and escrow deposits.) As of March 31, 1997, 26.8 percent of the HPTs' assets were funded by low costing demand deposits versus 24.2 for the industry aggregate. The HPTs' demand deposits had a WAC of 2.37 percent, slightly lower than the industry average of 2.48 percent.

The volume component of the interest expense-to-average assets ratio is measured by the ratio of interest bearing liabilities to total assets. A lower ratio of interest bearing liabilities to assets typically results in lower interest costs. The interest bearing liabilities-to-total assets ratio for the HPTs averaged 84.0 percent – approximately 4 percent lower than the industry aggregate ratio of 87.4. The

HPTs' advantage in this ratio stems from their higher than average level of both capital and non-interest demand deposits.

Higher capital levels tend to reduce the proportion of interest bearing liabilities needed to fund assets. As previously discussed, the HPTs' ratio of capital to assets of March 31, 1997 was 10.2 percent, approximately 30 percent higher than the industry aggregate ratio. In addition, the HPTs maintained higher than average capital levels throughout the 13 quarter period. At the beginning of this period (March 31, 1994) the HPTs' capital level was 10.3 percent versus 7.6 percent for the industry as a whole.

The HPTs held a slight advantage over the industry aggregate in the relative amount of non-interest demand deposits. As of March 31, 1997, HPTs' non-interest demand deposits represented 3.3 percent of assets, approximately 27 percent more than the industry average of 2.6 percent. Along with higher capital, this advantage in non-interest demand deposits helped reduce the proportion of interest bearing liabilities

Higher HPT Fee Income Generated Primarily from Servicing and Demand Deposits

HPTs (excluding the two credit card specialist HPTs) generate substantially greater relative amounts of fee income than the industry as a whole. Fee income to average assets measured an average of 59 basis points for the HPTs for over the 13 quarter period compared to an average 41 basis points for the aggregate industry over the same period. Reflecting the high amounts of fees produced by credit card operations, the two credit card specialist HPTs' fee income-to-average assets ratio was 117 basis points -- almost triple the industry average.

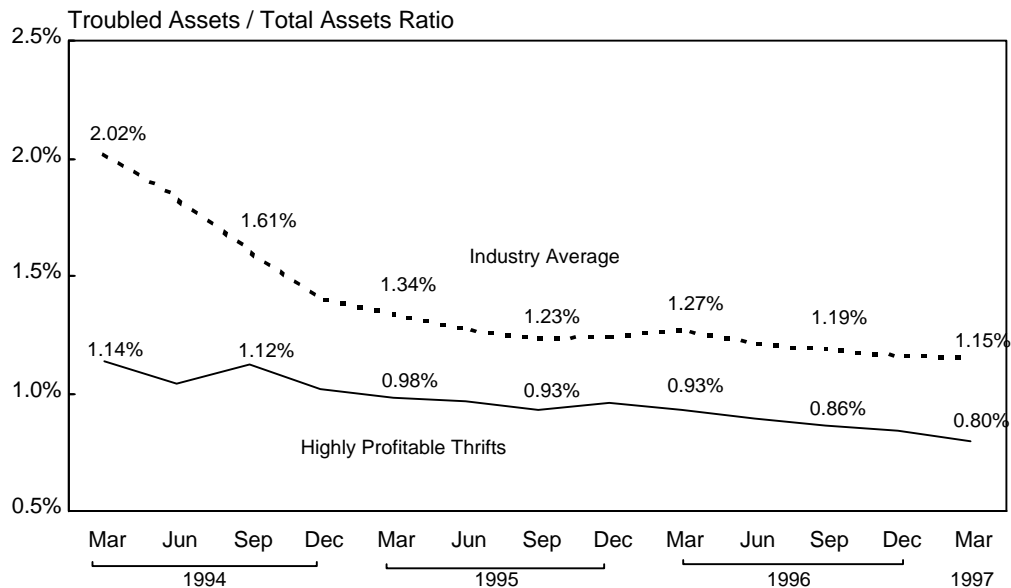
Higher relative fee income for the non-credit card specialist HPTs was primarily attributable to greater amounts of loan servicing, transaction accounts and non-interest demand deposits ("checking accounts"). The HPTs' loan servicing portfolio averaged 48 percent of total assets during the 3 year period, or 14 percent higher than the average industry aggregate ratio of 42 percent. The HPTs' larger servicing portfolio resulted in a 7 basis point edge in servicing fee income to average assets over the industry aggregate average ratio of 10 basis points.

HPTs also enjoy an advantage over the industry aggregate in "other fee income" to average assets. This advantage appears to be attributable to the HPTs' higher than average level of checking accounts which tend to generate more fee income than other types of deposits. Excluding the credit card specialist HPTs, the HPTs' checking accounts totaled 9.1 percent of total assets

as of March 31, 1997 – 34 percent more than the industry average of 6.8 percent.

Lower HPT Loss Provisioning Reflects Above Average Asset Quality

The HPTs' average ratio of provisions for losses to average assets (14 basis points) was just one-half of the industry average of 30 basis points for the past 13 quarters. The HPTs' lower provisioning reflects this groups' consistently better asset quality. As of March 31, 1994, the HPTs' ratio of troubled assets to total assets was 1.14 percent, 44 percent lower than the industry aggregate ratio of 2.02 percent. In general, the HPTs maintained a lower than average ratio of troubled assets throughout the period. As of March 31, 1997, the HPTs' troubled assets-to-total assets ratio measured 0.80 percent -- a 30 percent reduction from the level three years earlier. The industry aggregate ratio declined at a slightly faster pace, falling 43 percent to 1.15 percent as of the first quarter 1997 from the first quarter of 1994. The chart below presents the troubled assets-to-total assets ratios for the HPTs and the industry average from March 1994 through March 1997.

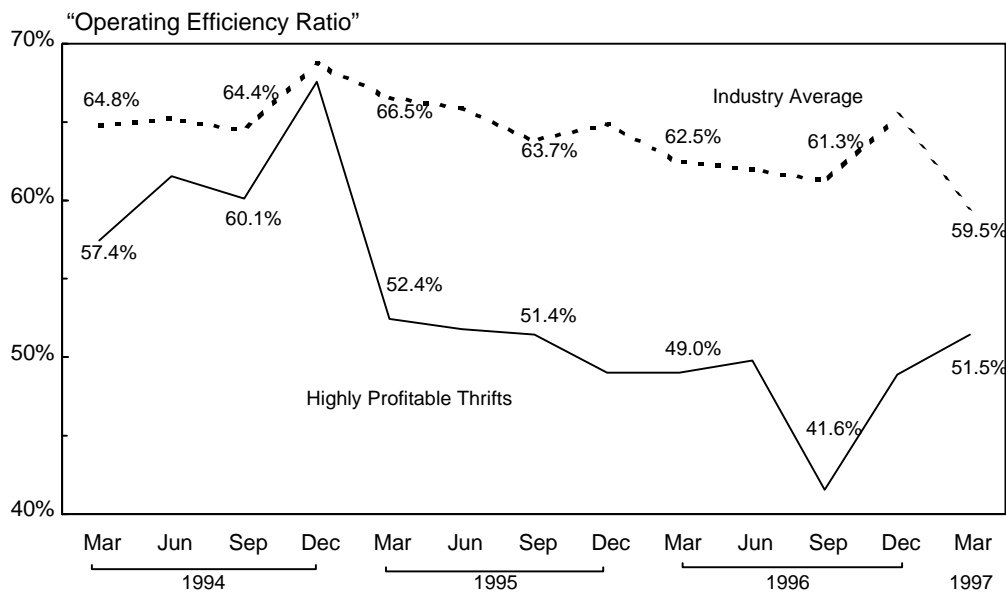


Credit card loans typically have higher rates of delinquency than other types of loans made by thrifts. This held true for the two HPT credit card specialists. These two thrifts' troubled assets ratio was 1.56 percent as of March 31, 1997 – 36 percent above the industry average.

HPTs Operating Efficiency Better Than Average

There are two measurements typically used to quantify the relative amount of profitability consumed by overhead expense: 1) the ratio of general and administrative expense ("G&A") to average assets; and 2) the ratio of G&A to "core" income. (Core income is defined as net interest income plus fee income.) Although the first ratio is a commonly used measure of relative overhead cost efficiency, it has one significant bias or disadvantage. By construction, the ratio of G&A to average assets favors asset intensive operations over more transaction oriented activities.

The ratio of G&A to core income, or "operating efficiency ratio", is a more "strategy neutral" measure of operating efficiencies. In general, the operating efficiency ratio attempts to measure the amount of core income generated per dollar spent to generate that income. A lower operating efficiency ratio indicates greater efficiency since a thrift requires lower expense to produce a given amount of core income. The following chart presents the operating efficiency ratios for the HPTs and the industry as a whole from March 1994 through March 1997.



The HPTs' G&A to average assets ratio, excluding the credit card specialists, averaged 216 basis points for the 13 quarters, 4.3 percent higher than the industry aggregate average ratio of 207. (The estimated net SAIF special assessment was excluded from G&A for the third quarter of 1996.) In contrast,

the HPTs' average operating efficiency ratio was 53.2 percent, 17 percent lower than the industry aggregate's average ratio of 64.2 percent. The lower "operating efficiency ratio" for the HPTs indicates that G&A consumes a smaller proportion of their core income than for the industry as a whole. Hence, the HPTs are receiving a higher than average "return" (core income) for the amount spent (G&A) to generate income.

Conclusions

The HPTs were very profitable.

The HPT "test" was rigorous – ROA of at least 100 basis points in each quarter over the past 3 years (excluding the third quarter of 1996 when the SAIF special assessment was expensed). The thrifts that were able to meet the HPT test were not only consistently profitable but were also highly profitable, averaging an ROA in excess of 160 basis points for the period.

Most HPTs are community-based, mortgage specialists.

In general, the HPTs could be characterized as community-based lenders holding a wide spectrum of loan products but specializing in mortgage lending, particularly fixed-rate single-family mortgages. Two of the 102 HPTs were "credit card specialists", i.e. holding the majority of their assets in credit card loans. However, even these 2 thrifts were not singularly focused on credit card loans but actually held a wide variety of other loan types in portfolio.

The HPTs have sound fundamentals.

Strong asset quality, solid capital, and favorable operating efficiency ratios were typical among the HPTs. Moreover, the management ratings the HPTs received from their OTS Safety and Soundness Examinations were significantly better than industry averages. At December 31, 1993, the quarter prior to the beginning of the HPT test period, 93.1 percent of the HPTs had a management component rating of "1" or "2" – the two highest ratings. This was 16 percent higher than the industry average of 80.2 percent. As of March 31, 1997, the gap between the management ratings for the HPTs and the industry as a whole narrowed to 11 percent as 97.1 percent of HPTs received a "1" or "2" rating versus the industry average of 87.7 percent.

Some risks are inherent in generating strong earnings.

As a group, the major risk confronting the HPTs was their higher than average amount of interest rate risk. Gauged by the OTS Interest Rate Risk Model, the sensitivity measure for the HPTs was higher than for the industry as a whole.

The HPTs' high sensitivity measure, however, was offset by their stronger capital resulting in a substantially stronger than average exposure measure for the HPTs.
